

DCI CABINET BRIEFING

July 1, 1977

Soviet Economic Problems and Prospects

Today I would like to give you a brief run-down on the highlights of a very important CIA study on the Soviet economy which will be released soon. I have already provided a gist of this study to members of the Joint Economic Committee's Subcommittee on Priorities and Economy in Government. I think it only fair to note that DIA and State/INR feel that CIA overstates the Soviet energy problem and the leadership's inability to cope with it.

- I. The thrust of the study is that the outlook for the Soviet economy is more bleak and the prospects for policy choices more uncertain than at any time since Stalin's death.
  - A. The USSR will soon enter a period of reduced growth potential with possible bottlenecks in key commodities, especially crude oil, which could reduce growth even further.
  - B. The basic problem is that the formula for growth used over the last 25 years--maximum inputs of labor and capital--will no longer work.
  - C. Moscow also will be confronted with a new set of difficult policy problems, especially involving energy use, imports from the West, relations with Eastern Europe, and the growth of military spending.

II. The reasons for poor Soviet economic prospects include the following:

(GRAPHIC: 1  
Working Age  
Population)

- A. The number of new entrants into the labor force will become much smaller in the 1980s.
- B. Productivity gains have been slowing for years and new problems will likely depress productivity.
- C. In particular, they too are going to face an energy crisis:

(GRAPHIC: 2  
Oil Production)

- 1. They are not finding and developing new oil deposits rapidly enough to offset declines in older fields. As a result, production will begin to fall in the late 1970s or early 1980s.
- 2. Last year's oil production of 10.4 million b/d was close to the estimated maximum potential of 11-12 million b/d. We expect oil output to fall to 8-10 million by 1985.
- 3. Current Soviet oil policy focuses on short-term gains in output at the expense of maximum lifetime recovery. Even so, production in the West Siberian fields, which are the source of the increases in oil output in recent years, will soon peak.

4. The Soviets will need US-made high capacity submersible pumps to stave off or slow the expected fall in production even temporarily.
  5. Beyond the mid-1980s, the USSR is counting on developing large new supplies of oil, gas and coal mainly in remote areas. To do this they will need a great deal of US technology.
  6. Even if the development of other energy sources is pushed to the maximum, the rate of growth of energy output is expected to fall sharply in 1981-85.
- D. How Moscow copes with the energy problem will have a far reaching impact.
1. Large sources of oil saving are difficult to identify in the USSR.
  2. Moscow thus either will have less energy to support economic growth or will face a turnaround from its present net energy export position to a net import position.
  3. The more the Soviet government delays adoption of a top-priority energy program the greater the economic impact in the 1980s.

III. A marked reduction in the rate of economic growth in 1980s seems inevitable.

(GRAPHIC: 3  
GNP Growth)

- A. A plausible forecast is a growth of GNP of about 4 percent a year through 1980, and roughly 3 percent in 1981-85. By comparison, growth averaged  $4\frac{1}{2}$  percent in the past decade.
- B. Economic growth could be further constrained by an energy shortage if the output of energy falls to the lower end of the expected range.
- C. The possibility of achieving substantially higher growth seems small even though the government has a variety of options, such as keeping older workers on the job longer, and shortening the term of service in the armed forces. Moreover, energy supplies are a limiting factor even under optimistic assumptions.
- D. The reduced growth potential means that the Soviet consumer will fare poorly during the next five to ten years relative to recent gains.
  - 1. With an aging labor force and consequent wage creep, the increasing amount of disposable income combined with a slower growth in the availability of consumer goods will result in inflationary pressures and growing frustration for the consumer.

IV. There are a number of important implications to be drawn from what I have recounted above.

A. The slowdown in economic growth is likely to trigger intense debate in Moscow over the future levels and patterns of military expenditures. But military programs have great momentum and powerful political and bureaucratic support.

1. We expect defense spending to continue to increase in the next few years at something like recent annual rates of 4 to 5 percent because of programs in train.
2. As the economy slows, however, ways to reduce the growth of defense expenditures should become increasingly attractive to major elements of the Soviet leadership. Defense programs essential to an appropriate balance of forces will be maintained, but the economic incentive to seek arms agreements that limit US arms competition will be greater.

B. Moscow's economic problems in the 1980s will strongly affect its relations with the West, especially the US.

1. Last year oil accounted for half of the USSR's hard currency earnings.
  2. Even under favorable assumptions for hard currency earnings, Soviet ability to import from the West in the early and mid-1980s will almost certainly decline.
  3. Moscow, therefore, may ask for long-term credit (10-15 years), especially to develop oil and gas resources.  
The USSR needs US technology to do this rapidly. Long-term credits would require government guarantees.
- C. Eastern Europe may be hit hard by Soviet decisions in oil.
1. Soviet commitments for oil deliveries to Eastern Europe in 1980 are a diversion of about \$7 billion in potential Soviet hard currency earnings.
  2. There will be strong pressure to force Eastern Europe to share the burden of the oil shortage but a substantial cut in oil supplies to Eastern Europe would worsen its already difficult economic situation and may threaten political stability there.

D. As Soviet leaders obtain a better perception of the resource problems ahead, they will be led to consider policies rejected in the past as too contentious or lacking in urgency.

1. Some leaders might be persuaded that basic organization and management reforms in industry are necessary. But that will raise the spectre that such reform would threaten political control.
2. Consideration of other options -- such as accelerating investment at the expense of defense or consumption, or reducing the armed forces to enhance the civilian labor force -- could also result in strong leadership disagreements.

E. Soviet responses to economic problems will be severely complicated by the fact that the leadership stability will almost surely weaken during the coming period. The aging leadership group

is unlikely to face hard decisions and consider novel responses. Not until a new and vigorous leadership is in power is it likely that the Politburo will come to grips with the difficult problems of the Soviet economy.

\* \* \* \*

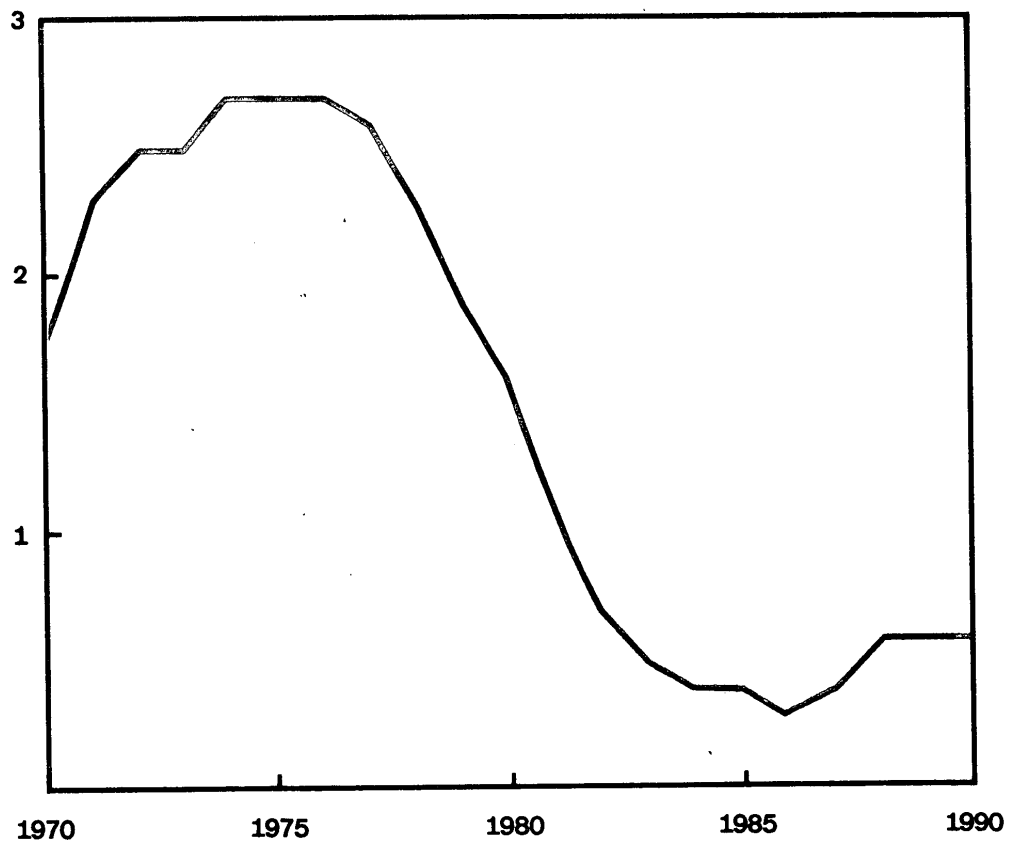
The classified CIA study will be ready for release later this week. It has already been summarized in the NID. Next week we hope to release an unclassified version to the public under the auspices of the Joint Economic Committee.



## USSR: Population of Working Age, Annual Increments, 1970-1990

Figure 1

Million Persons (mid-year)



## Soviet Crude Oil Production

Figure 2

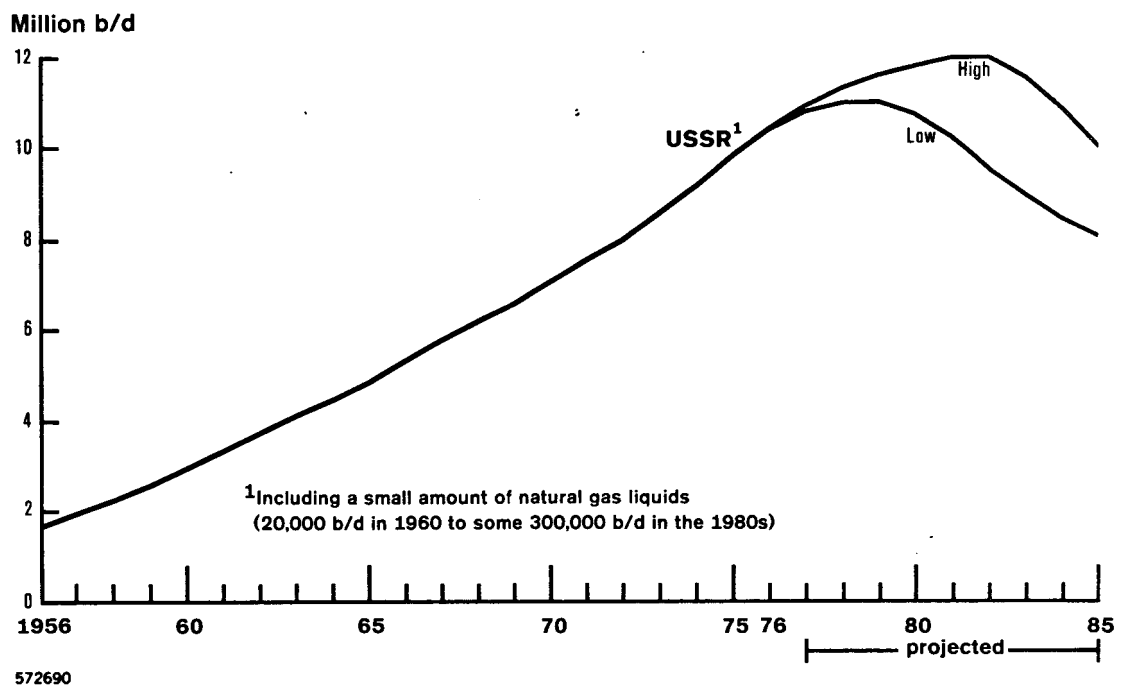
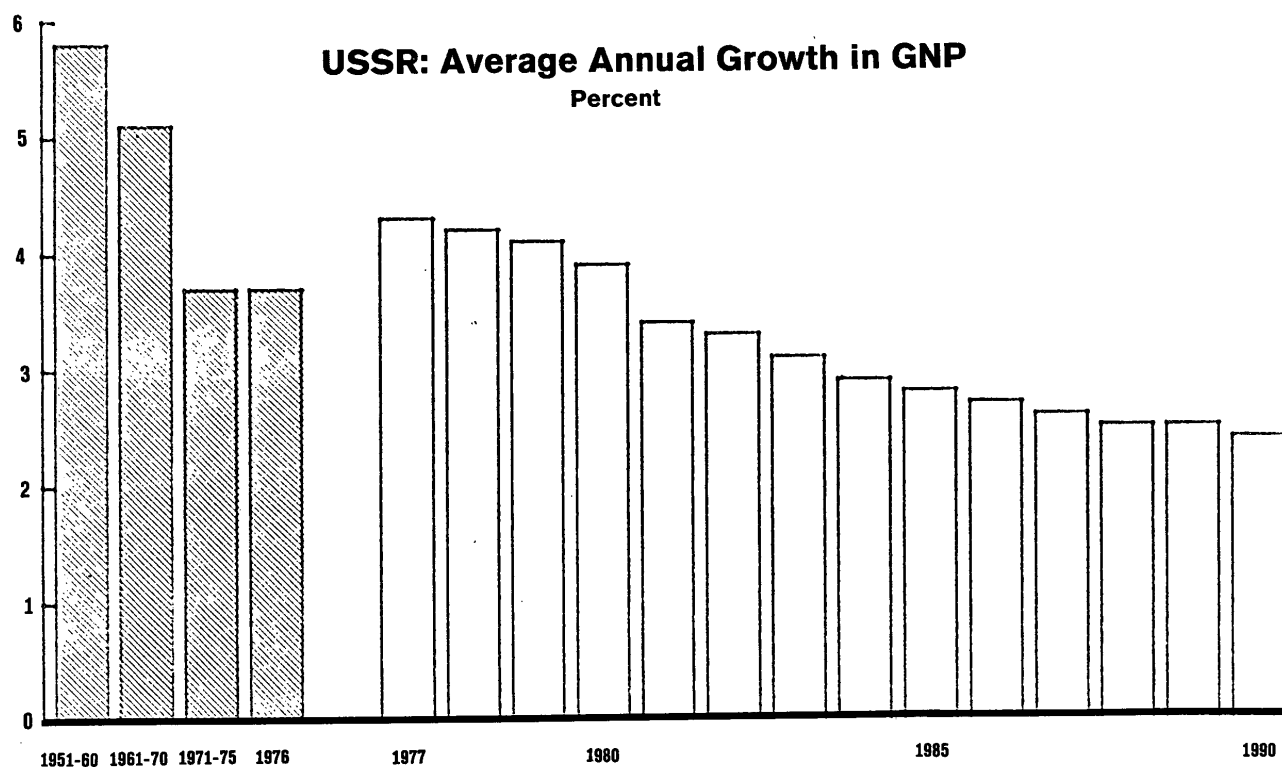


Figure 3



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Intelligence Problems

- I. I'd like to review for you all some of the analytical problems that we regularly confront as an intelligence organization. Some of them are perennial--a foreign [redacted] for instance, or the military intentions of traditionally hostile neighbors. Others are more transient, but no less pressing. The examples I'll enumerate include problems of both types, and they've all been at issue in recent weeks.
- II. At the head of our current intelligence problems is Brezhnev's health. It has long been the key, yet imponderable, factor in evaluating the political position and tenure of the world's No. 2 political figure.
- A. It is a particularly critical problem now because of Brezhnev's seeming display of political assertiveness in taking over the post of president last month in addition to his top party post. Were Brezhnev in reasonably fair shape--as was assumed at the time--this move logically had to be seen as a likely prelude to a new era of personal influence.

B. [redacted]  
[redacted]

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that his health is even poorer and may be declining at a faster rate than we had previously believed.

1. If this is the case, it puts a somewhat different light on his assumption of the presidency. It is even conceivable that this move was acquiesced in by his colleagues because they viewed its effects as temporary.

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IV. The problem from an intelligence point of view is that current information is insufficient to judge with any confidence the details of Brezhnev's health. [REDACTED]

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A. This is in contrast to the period in 1975 when he was out of sight for long periods of time and obviously in poor health. [REDACTED]

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B.

C.

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bounce back, but not with the same vigor and not  
for as long a period as after his last period of  
extended rest.

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VI. In the European area, one of our more interesting intelligence problems stems from the recent Soviet attack on Spanish Communist leader Carrillo. He has long been an especially irritating thorn in Moscow's side. He has been much more blunt than his French and Italian counterparts in his criticism of the Soviet system, and he has gone so far as to charge that the Soviet Union has never "achieved socialism" in the Marxist sense.

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VII. [REDACTED]

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VIII. The Republic of Djibouti (formerly the French Territory of the Afars and Issas) gained formal independence from France on June 27. Independence has not, however, removed the problems--and in fact may have aggravated some of them--that make this small territory important for US foreign policy and the intelligence community.

IX. Djibouti bears a strategic importance out of all proportion to its size and lack of wealth. It has a seaport on the African Horn, at the mouth of the Red Sea, and this makes it the focal point for the attention of the USSR, the US, Israel, and the Arab world. Djibouti's potential for triggering an armed conflict between neighboring Ethiopia and Somalia is of immediate concern for all these countries.

A. For the US, the concern is over further Soviet inroads into the Horn of Africa and over how to head off, or at least be prepared for, a major flareup in the region.

B. [REDACTED]

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X. Against these concerns, the problem for the intelligence community is simply put, but not simply solved: to know what is going to happen before it occurs or at least to obtain enough information to provide the basis for estimating what is likely and to give warning.

A. This requirement is not easily met. The US presence in Ethiopia has been drastically reduced, [REDACTED]

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[REDACTED] Despite the signs of an improvement in US-Somali relations, US access to high-level policymakers in Somalia is also limited.

1. In Djibouti itself, we have only a small consulate

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[REDACTED]

2. We also lack access to high-level Soviet policy deliberations on Djibouti.

3. Finally, there is a high potential for what we would view as "irrational" action on the part of both Ethiopia and Somalia toward Djibouti.

B. Despite these problems, the totality of the intelligence we have on the Djibouti issue gives us reasonably high confidence that we can estimate the situation

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and provide proper warning.

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the experience of our analysts allows us to fill in most of the missing pieces. Our track record gives us confidence that we will be able to provide the kind of intelligence support required.

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